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**FAR EAST/PACIFIC BRANCH
OFFICE OF REPORTS AND ESTIMATES
CENTRAL INTELLIGENCE AGENCY**

WORKING PAPER

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INTELLIGENCE HIGHLIGHTS NO. 36
20 JANUARY - 25 JANUARY 1949

SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

A Chinese Communist statement of policy towards Japan pointed out that revival of trade between the two areas hinged on the elimination of reactionary elements in the Japanese Government and emphasized that the "New China" intended to have a voice in Japanese affairs, along with the other major powers (page 2).

Burma and Japan have concluded a trade agreement covering the exchange of \$25 million worth of goods in 1949 (page 3).

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Beiping capitulated to the Chinese Communists this week and CHIANG's defeated armies were reported withdrawing south from the Yangtze defense line (page 7). CHIANG Kai-shek "retired" (page 7) and left to LI Tsung-jen the task of concluding a peace with the Communists who have not wavered from MAO Tse-tung's eight point demand for virtual unconditional surrender (page 8).

The Philippine Government is adopting stringent security regulations in view of possible influx of agents from China (page 10).

Burma is faced with a serious economic crisis and is seeking foreign financial assistance (page 10).

The Siamese are studying anti-Communist measures (page 11).

Korean rightist youth groups are being consolidated under President Rhee's orders (page 5).

The marginal notations used in succeeding sections of this Weekly ("A", "B" or "C") indicate the importance of the items in B/FE opinion with "A" representing the most important.

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Chinese Communists state policy towards Japan

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A Chinese Communist Party broadcast from North Shensi on 19 January, reveals an increasingly conscious aggressiveness in development of a Chinese Communist policy for Japan. Aimed at influencing the Japanese general elections of 23 January, the Chinese Communist radio emphasized that after 8 years of combating Japanese imperialism, "New China," unwilling to deal with Japanese reactionary elements, finds "Japanese Communists and other democrats" best qualified to lead Japan to a "genuine close friendship" with China. Dangling the prospects of renewed China trade before market-seeking Japan, the broadcast stated that while Japan needs to establish economic and political relations with "People's China," "Japanese reaction" possesses nothing on which China must rely. The Chinese Communists further announced that "whether American imperialists and their Japanese pawns are willing or not," the "New China" will concern itself with control of Japan.

Probably the North Shensi broadcast contributed little to the surprising election success of the Japan Communist Party (JCP). (The JCP increased its lower house Diet seats from 4 to 35 out of 466 seats.) The "New China" pronouncement, however, played on the same note which JCP campaign psychology has stressed, namely, that Japan has much to gain by being friendly with a Communist China.

Chinese Communist allurements to Japan for potential economic relations may be of considerable significance. Chinese Communist planners do not expect extensive economic support from the USSR and may desire to resume trade between these two economically complementary areas with the thought that, through gradual, judiciously applied pressure, they can assist the JCP. (SEE SECTION III)

The expressed desire to participate in the control of Japan may indicate a two-fold ambition: (a) to play upon Japanese fears of a Communist China while putting pressure behind a jump-on-the-bandwagon movement, and (b) to help counter American influence in the Far East. Possibly anticipating international recognition of a Communist-controlled Government of China, the Chinese Communist Party undoubtedly aspires to China's present seat on the Far Eastern Commission, where China holds veto power, and on the purely advisory Allied Council for Japan, which "New China" could employ as a sounding board to mould Far Eastern opinion.

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GENERAL (continued)

Japan-Burma trade arrangement concluded

Japan and Burma have concluded a trade arrangement covering the period of 1 January to 31 December 1949. The arrangement contemplates a trade balanced at 25 million dollars and is similar in outline to the over-all sterling area trade arrangement negotiated in the autumn of 1948. It provides for the purchase of raw cotton, rice, lead, antimony, tin concentrates, teak and rubber by Japan in exchange for cotton piece goods, silk and rayon goods, cotton yarn, corrugated iron sheets, truck tires, tubes, pottery and porcelain.

Before the war, Burma was not important in the foreign trade of Japan proper, accounting for only 0.6 percent of exports (mostly cotton goods) and 0.3 percent of imports (raw cotton and zinc). Currently, however, trade with Burma is important to Japan because it affords a trade channel in Southeast Asia, an area which Japan is anxious to develop so as to lessen its economic dependence on northeast Asian markets, now in large part Communist-dominated. Trade with Japan is important to Burma because before the war Japan was a significant market for one of Burma's major exports--raw cotton.

The trade arrangements may encounter difficulties. It is problematical, for example, whether the International Emergency Food Committee (IEFC) will permit the allocation of rice to Japan. In addition, instability in Burma will make both the production and export of the required commodities difficult.

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KOREA

Youth groups consolidate. Premier Lee Bum Suk has instructed his Korea National Youth Corps (KNYC) to accede to President Rhee's ultimatum requiring it to join the Great Korea Youth Corps (GKYC). Rhee has been attempting to consolidate all rightist youth organizations in a single allegedly "non-political" front, under his indirect leadership, designed to defend the Republic against Communism and to serve as the nucleus of a projected 50,000 man Militia. Premier Lee had built a strong political following on the basis of his leadership of the KNYC, and his initial hesitation in ordering it to merge with the GKYC under Rhee's nominal leadership incurred the President's displeasure. While the Premier's recent action may improve his relations with Rhee, Lee will probably continue to fight for political leadership of Korean Youth by attempting to place KNYC members in key positions in the GKYC, the Militia and the Army. Since the GKYC is to serve as the nucleus for the Militia, which

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KOREA (Cont.)

will be under Lee's control in his position as National Defense Minister, he can probably regain much of the power that he now exercises as Chief of the RNYC in the Youth Corps. The recent appointment of Lee Chun Sik, formerly a RNYC deputy, as commanding officer of the regiment assigned the politically important mission of defending Seoul, is indicative of Lee's political strategy.

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CHINA

Nationalist organized military resistance ends. The completely demoralized and defeated armies of CHIANG Kai-shek are reported to be retreating south from the Nanking-Shanghai area and the Yangtze defense line. The oncoming Chinese Communist armies are believed to have reached the Yangtze and currently to be awaiting orders to cross the river. Prior to this latest Chinese Communist advance, CHIANG Kai-shek, at long last, decided to "retire" and departed for Fenghua to "sweep the tombs of his ancestors." When CHIANG left, he turned over the confused remnants of his regime to Acting President LI Tsung-jen, who is at present frantically attempting to negotiate an "honorable peace" with the Chinese Communists. However, with the disintegration of organized Nationalist military resistance, LI's bargaining power is nil and he can expect little better terms from the Chinese Communists than unconditional surrender.

Meanwhile, with the calm capitulation of the ancient North China capital of Peiping on 22 January, the Chinese Communists added another victory to their list and deftly administered the 'coup-de-grace' to the Nationalist military position in North China. Nationalist Gen. FU Tso-yi surrendered Peiping to the Communists, in exchange for a guarantee of his personal safety and the removal of his name from the Communist list of "war criminals." FU apparently made this deal with a view toward getting out later and returning to his home territory in Suiyuan Province. The Communists, on the other hand, probably are aware of FU's intention to "go back to the farm," and therefore will make every effort to keep him under their thumb so as to forestall any possibility of his ever again becoming a formidable adversary.

The peaceful capitulation of Kalgan, Tientsin, and Peiping has set a pattern which will probably be followed by the defenders of the remaining Government-held cities of Nanking, Shanghai, Hankow, Tsingtao, Sian and possibly Taiyuan. Consequently, the last major engagement of China's civil war appears to have been concluded.

CHIANG Kai-shek "retires." CHIANG's decision to retire from the Presidency of the National Government, at a time when its collapse is imminent, evidences his intention to demonstrate that Vice President LI Tsung-jen cannot make an "honorable" peace with the Communists and that continued resistance under CHIANG's leadership is the only alternative to unconditional surrender. CHIANG's action is also calculated to put on the Communists the onus for declining to halt their attacks except on terms contemplating early communization of Nationalist China.

Legally, CHIANG's "retirement" involves no more than his absence from the presidential office, to which he may return at will. He still heads the Kuomintang and its committees still control the National

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Government. Moreover, he has recently strengthened his authority in various provinces of South and Southwest China by the appointment of dependable subordinates to key positions. While plans have been partially carried out to use Taiwan as an ultimate haven for Nationalist leaders despite the possibilities of a native uprising there, CHIANG has made additional preparations to employ South China as a base of resistance and has moved Government resources, records, and personnel both to South China and Taiwan. If LI's efforts to make peace are futile, CHIANG will be in a position to resume active direction of the National Government and may eventually head a government-in-exile with the hope of recovering control of China as a consequence of World War III.

Acting President LI's newly appointed peace delegates, SHAO Li-tze and CHANG Chih-chung, have little to offer the Communists and realization of their difficulties probably will impel the majority of Nationalist leaders who still possess regional authority to attempt further resistance, probably in cooperation with CHIANG Kai-shek. Leftist leaders and lesser Nationalist figures may accommodate themselves to conditions of Communist rule, somewhat as those in the Peiping-Tientsin region have done.

Joint Communist-Nationalist administration set up in Peiping.

PU Tso-yl's agents accepted terms of surrender for Peiping which will facilitate a gradual and orderly assumption of power by the Communists and which involve the cooperation of Nationalist military and civilian officials during the transitional period. Another provision of this acceptance is the future inclusion into the Communist forces of all Nationalist troops in Peiping. Probably some of the peace-makers will be given at least temporary roles in the Communist administration. Meanwhile, Marshal LI Chi-shen and other dissidents who reportedly have been conferring with Communist representatives at Shihchiachuang, south of Peiping, issued a statement, broadcast over the Communist radio, which denounced Nationalist peace overtures and otherwise adhered closely to recent Communist propaganda lines. Marshal LI's Kuomintang Revolutionary Committee may serve as a vehicle for admitting a limited number of Kuomintang members acceptable to the Communists into the future Communist-dominated coalition government.

Communists view CHIANG as principal enemy. Chinese Communist broadcasts have denounced CHIANG's "retirement" as a tactical maneuver inspired by the US and have accused the US and the Kuomintang of plotting to build up South China and Formosa as bases from which "to destroy the revolution." The Communists are genuinely concerned over CHIANG's prospects, with US assistance, for delaying total surrender in China.

The Communists have made clear that realization of MAO Tse-tung's eight-point program is their aim; the presence of specific individuals

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on their list of "war criminals" is the only point susceptible to modification. As bargaining points in his favor, Acting President LI will claim both control over remaining Nationalist forces and international status as the legal National Government of China. It is doubtful that LI's government really has such control or such status. MAO's insistence upon the "reorganization" of all Nationalist Armies is likely to split LI's government sharply into two groups, with only those who control no significant military forces favoring settlement. The other group can hold out temporarily in South and west China, and may at any time join forces with CHIANG Kai-shek upon his return from "retirement."

The Communists are well aware that the Generalissimo is playing for time. Thus, while the Communists will accept with pleasure whatever concessions are offered them by the ineffectual government in Nanking, their principal enemy is and will remain CHIANG Kai-shek, who will not compromise with the Communists and who will continue to be a serious obstacle to the realization of the Communist aims as long as he retains any vestige of military or political authority.

Recall of Soviet Ambassador implies policy change. A change in Soviet policy in China may be indicated by the recall of Soviet Ambassador N. V. Roshchin. Gen. Roshchin, former Military Attache, was appointed Ambassador in February 1948 after conferences in Moscow. The USSR apparently concluded that the US program of aid to China, announced at that time, was certain to be a failure and therefore that the Chinese Government might well accept a Soviet offer to mediate in the civil war which Roshchin had already advanced informally. Since Communist successes throughout 1948 made Soviet mediation either unnecessary from the Soviet viewpoint or undesirable from the Chinese Communist viewpoint, the USSR recently declined the National Government's invitation to mediate. Roshchin has again been called to Moscow, and Soviet affairs in Nanking will again be entrusted to a Charge d'Affairs who presumably will be unable to commit the USSR to a course of action in the absence of an Ambassador. Roshchin's contacts and operations for the past several years have been with the Chinese Nationalists rather than with the Communists. It is therefore quite possible that Roshchin will not return as Ambassador.

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PHILIPPINES

Government worried about influx of agents. The US Military Attache in Manila has reported that the Philippine Government is becoming increasingly concerned over the possibility of foreign agents infiltrating the Philippines. He states that civil and military intelligence agencies are imposing stringent restrictions over the incoming stateless Shanghai refugees who are being permitted temporary asylum in the Philippines. Security measures adopted by Philippine officials may also be inspired by recent reports that Chinese Communists are being smuggled into the Philippines. Col. Marcus V. Augustin, chief of a group of special agents attached to President Quirino's office, recently reported that some 40 Chinese—including a number of Communists, smugglers, and Nationalist deserters—have entered Zamboanga Province on the southern Philippine island of Mindanao. Although there are probably few actual Communist entries into the Philippines at present, greater infiltration is possible in view of: (1) the Philippine Naval Patrol's inability to guard the long Philippine coastline against smuggling activities and illegal entry; and (2) inefficient and corrupt administration of the Philippine immigration laws.

BURMA

Government needs foreign loans. It is becoming increasingly evident that Burma's internal difficulties are steadily undermining the country's financial stability. Not only is the Government burdened with heavy military expenditures, but the various insurrections are seriously interfering with exports the operations of Government-owned utilities and the collection of taxes. In addition to Government efforts to deal with the critical financial situation by cutting cost-of-living allowances to Government workers and promulgating an "austerity program", foreign financial assistance is being sought. The Information Minister has requested Burmese newspaper editors to tone down their attacks upon "Anglo-American imperialists and bloodsucking capitalists" in order to avoid antagonizing prospective leaders. India and the UK are the most likely sources of loans because Burma's rice is of great importance to both. India needs all the rice it can get for its own use, and the UK needs rice for the food-deficit areas of the Far East, particularly in Malaya, which produces a large amount of dollar exchange. The UK is reported ready to loan Burma 200 million rupees (about \$67 million.) It is expected that a request will be made of India. Such loans, however, will only have a temporary effect until law and order are restored, and offer little prospect of fundamentally improving Burma's deteriorating economy. The Burmese Government is not believed capable of enforcing comprehensive austerity, or checking inflationary conditions. The reduction of governmental allowances may lead to strikes by Government workers which will further curtail the Government's capacity to function effectively.

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SIAM

Government studies anti-Communist measures. Although the Siamese Government espouses no definite anti-Communist program, Premier Phibul indicated at a press conference last week that the government is examining measures to combat Communism. The Phibul government is aware that Communism is confined chiefly to Siam's large Chinese minority which dominates the labor force and the mercantile class. The government is, therefore, primarily concerned with the problem of limiting Chinese control of labor unions and the reservation of certain occupations to Siamese nationals. Furthermore, in an effort to remove possible causes for the spread of Communism among Siam's overwhelmingly agrarian population, the government is studying the advisability of reducing foreign land ownership and the possibility of increasing cooperative land-holdings.

At present, Siam has a promise of limited military aid from the UK and, in addition, is making strong overtures to the US for military and economic assistance as a means of withstanding Communism. Despite the apparent anti-Communism of the present regime, however, the Siamese are capable of making the adjustments necessary for dealing with a Chinese Communist government recognized by world powers. This would be entirely consistent with Siam's past history of opportunistic adaptation to political developments elsewhere in Asia.

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SECTION III. DIGEST OF IMPORTANT STUDIES AND ESTIMATES**ECONOMIC PROSPECTS IN MANCHURIA FOR 1949-50****SUMMARY**

The consolidation of Manchuria under Chinese Communist control is of major significance both to the Communist position in China and to Far Eastern trade. The reintegration of Manchuria's industries with the agricultural hinterland will permit expanded output, and restoration of the communications system will enable the Communists to mobilize surplus food and industrial raw materials for use in China and for export abroad. Under Communist control, Manchuria may in the next two years re-emerge as an important factor in Far Eastern trade, despite political factors which may affect the quantity and direction of Manchurian trade.

Prospective Production

Unified political control and restored communications will enable the Communists both to realize greater returns from Manchuria's agricultural surpluses and to exploit industrial raw material resources on a considerably increased scale. Light industry, of which the most important is textile production, will be stimulated by the return of peace to Manchuria. Even with a substantially increased output of cotton textiles, however, the local demand will not be met. The heavy industries, chiefly iron and steel, built by the Japanese in Manchuria, will probably remain largely inoperative until the machinery needed for their rehabilitation can be imported.

Prospective Exports

Increased output of industrial raw materials and agricultural products would have an immediate effect on trade in the Far East. Because of the serious deterioration of industrial plants, the Manchurian economy cannot now absorb all the raw materials it is capable of producing. Yet Manchuria's need of machinery for industrial rehabilitation and essential consumers' goods gives her a strong incentive to produce more than she can consume at home, in order to market these exportable surpluses.

In the next two years Manchuria should be able to produce a surplus of three million tons of grain and soybeans for foreign markets, 3-5 million tons of coal, 500,000 tons of iron ore, 400,000 tons of salt, and unestimated quantities of lumber, magnesite and molybdenum.

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Prospective Markets

The restoration of through transportation to the major ports in the south will greatly enlarge the potential market for Manchuria exports. The industrial cities of North China would import Manchurian grain. There will be a steady world demand for Manchurian vegetable oil and some minerals. Aside from political considerations, the Chinese Communist Party would find a natural market in Japan for Manchuria's surplus of soybeans, coking coal, salt, and iron ore. Japan is a potential supplier of those capital and consumer goods which Manchuria needs.

Political Considerations

Whether Manchuria's export potential will be exchanged in the most advantageous markets depends largely on whether political considerations determine economic policy. The USSR may be expected to influence decisions of the Chinese Communist Party regarding Manchurian trade, both by virtue of Soviet ideological affinity with the Chinese Communist Party and by the USSR's share in control of the important port of Dairen and the Manchurian railroad system.

Two political considerations may prevent the export of Manchuria's raw material surpluses to areas (such as Japan) which will give the Communists the greatest return. First, both the USSR and the Chinese Communists may agree that exports contributing significantly to Japan's economic recovery and war potential would be undesirable. Second, the example of Eastern European satellites indicates that the USSR, for its own security purposes, may well object to the industrial restoration of Manchuria, through exchange of raw materials for factory machinery.

In contrast, three considerations will encourage Manchurian trade with non-Soviet countries. First, from the Chinese Communist viewpoint, there is little hope for early industrial rehabilitation in Manchuria except through trade with countries like Japan that can provide the required capital goods in return. Second, Russia would share in capital goods imported from Japan, which would benefit the Soviet Far East economy as well as strengthen the Chinese Communist economy in Manchuria. Third, a large part of Manchuria's potential export commodities would be only of marginal significance to Soviet areas.

It may be concluded, that although economic forces will promote a substantial amount of trade between Manchuria and countries outside the Soviet Far Eastern bloc, political consideration will keep such trade well below its potential maximum during the next few years.

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